Supreme Court, U. S.
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1138

RALPH H. SCHULZ,
*Petitioner,*

v.

UNITED STATES OF AMERICA,
*Respondent*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURTS OF APPEALS FOR THE SEVENTH CIRCUIT

RALPH H. SCHULZ, Pro Se
9 High Point Cir., N.
Naples, FL. 33940
(813) – 261-6793

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QUICKPRINT "The Big Red Q", 4524 Tamiami Trail No., Naples, FL 33940

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IN THE

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OCTOBER TERM, 1979

No.

RALPH H. SCHULZ,
*Petitioner,*

v.

UNITED STATES OF AMERICA,
*Respondent*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURTS OF APPEALS FOR THE SEVENTH CIRCUIT

The petitioner Ralph H. Schulz respectfully prays that a writ of certiorari issue to review the order and judgment rendered in this proceeding on January 18, 1979 by the united States District Court, Eastern District of Wisconsin.

## OPINION BELOW

The decision and order of the United States District Court, Eastern District of Wisconsin, rendered on January 18, 1979, is recorded in the records as Civil Action No. 76-C-646. It is reprinted in the Appendix, (App. 1), hereto.

The United States Court of Appeals, Seventh Circuit, affirmed the order on November 1, 1979 without opinion. The case is recorded as Cause No. 79-1355. The Order is reprinted in the Appendix, (App. 6).

## JURISDICTION

After exhausting all remedies in the Internal Revenue Service ("I.R.S.") the petitioner filed timely complaint in the United States District Court, Eastern District of Wisconsin, on September 10, 1976. Jurisdiction was invoked under 28 U.S.C. 1346(a)(1). On January 18, 1979 order and judgment was entered in favor of the defendant.

Petitioner timely appealed to United States Court of Appeals, Seventh Circuit, on March 19, 1979. Jurisdiction was in-



voked under 28 U.S.C. 1291; 28 U.S.C. 1294(1) and Rule 4 of the Federal Rules of Appellate Procedure. On November 1, 1979 that Court affirmed the order of the District Court without opinion.

Jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## QUESTIONS PRESENTED

The original question in this case: "Which statutes, and how, did the taxpayer violate in computing his 1971 tax return" has developed into the following more fundamental questions:

A. Whether Article I, Section 1 and Amendment X of the United States Constiturion proscribe the use of constructive receipt for income tax purposes.

B. Whether the Sixteenth Amendment permits the laying and collecting of income taxes on expenditures.

C. Whether the Due Process Clause of the Fifth Amendment interdicts an income tax deficiency assessment when:

(1) The taxpayer was denied his fundamental right to be advised of how and which statutes he violated, and

(2) The taxing authority offers no valid statutory support for its method of computation.

D. Whether a tax deduction is appropriate in 1971 for state taxes paid in 1970 and already deducted from the tax return for 1970.

E. Whether a Court Order which is out of harmony with decisions of this and other Courts and which lacks statutory, regulatory or case support is valid.

## CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

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UNITED STATES CONSTITUTION, ARTICLE I:-

SECTION 1. All legislative Powers herein granted shall be vested in a Congress of the United States . . .

UNITED STATES CONSTITUTION, AMENDMENT V:-

No person shall be . . . deprived of life, liberty, or property, without due process of law: . . .

UNITED STATES CONSTITUTION, AMENDMENT X:-

The Powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.



UNITED STATES CONSTITUTION, AMENDMENT XVI

The Congress shall have the power to lay and collect taxes on income, . . .

REVENUE ACT OF 1921, SECTION 201(e):

For the purpose of this act, a taxable distribution made by a corporation to its shareholders or members shall be included in the gross income of the distributees as of the date when the cash or other property is unqualifiedly made subject to their demands.

REVENUE ACT OF 1924, SECTION 213(a):

The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

REVENUE ACT OF 1954:

26 U.S.C. 111(a), GENERAL RULE.- Gross income does not include income attributable to the recovery during the taxable year of a bad debt, prior tax, or deliquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount.

26 U.S.C. 164(a) GENERAL RULE.- Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

* * *

(3) State and local and foreign income, war profits, and excess profits taxes.

* * *

26 U.S.C. 446(a) GENERAL RULE.- Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b).- EXCEPTIONS.- If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary or his delegate, does clearly reflect income.

(c) PERMISSIBLE METHODS.- Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting -

(1) the cash receipts and disbursements method;

* * *

26 U.S.C. 451(a) GENERAL RULE.- The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

TREASURY DEPARTMENT REGULATION:

26 C.F.R. 1.451-1(a) GENERAL RULE;- Gains, profits and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting . . . (Emphasis shows expansion of statute)



## STATEMENT OF THE CASE

**********************

This civil action involves an invalid income tax deficiency assessment for the year 1971, which was paid on December 3, 1973. Refund claim was timely filed on February 26, 1974. After exhausting all I.R.S. remedies petitioner filed a timely Complaint in the United States District Court, Eastern District of Wisconsin on September 10, 1976 under provisions of 28 U.S.C. 1326(a)(1).

The relevant facts which are either stipulated or not contested are:

1. Petitioner is a cash basis calendar year taxpayer for both federal and state income taxes, (Stip. 2).

2. Since about 1955 petitioner has paid state and local taxes for two years in even numbered years and paid no such taxes in odd numbered years, (Stip. 19 and 20, Ex, D, p. 5).

3. In 1970 petitioner paid his 1970 and 1971 state income taxes through payroll withholding. On his 1970 return he took these 1970 withholdings as an itemized deduction. He did not have any refund of these prepaid taxes nor was there ever any likelihood that he would have

such a recovery, (Stip. 8 to 16; Appellant's Brief, p.3).

4. "Wisconsin Statutes clearly allow advance payments of state income taxes to be made at the election of the individual taxpayers. Wis. Stat. 71.10(9), 71.21(6)." (Def. Brief, p.9).

5. "Upon audit of his federal income tax return for 1971, the Internal Revenue Service adjusted Mr. Schulz's 1971 gross income to include the $2,577.29 of Wisconsin state income taxes prepaid in 1970", (Stip. 21). (Emphasis added).

6. The "Internal Revenue Service allowed, for 1971, itemized deductions totaling $2,868.13 to be taken for state income tax, sales tax, and gasoline tax in lieu of the $1,500 standard deduction." (Stip. 25). (Emphasis added).

7. In 1971 petitioner paid no income taxes to the state either through payroll withholding, (Stip. 21), or in any other manner.

8. Petitioner "contested the $2,577.29 adjustment for 1971 and pursued his administrative remedies through the district conference level", (Stip.24), where he signed and paid the deficiency assessment under duress.



## REASONS FOR GRANTING THE WRIT

A. This case presents a federal constitutional and statutory problem concerning the validity of the use of the constructive receipt doctrine for income taxation.

1. The respondent cited Adams v. Commissioner, 1930, 20 B.T.A. 243 to support its assertion that constructive receipt is statutorily approved for income taxation, (Appellee's Brief, p. 6). However, an examination of this case reveals that:

(a) The Revenue Act of 1921, sec. 201(e), provided that constructive receipt was applicable only to corporate distributions to shareholders and members.

(b) In the Revenue Act of 1924 the Congress completely extirpated this constructive receipt doctrine for income tax purposes. Although the House wanted to expand the use of this doctrine, the Senate removed all provisions therefor from section 213(a), which, as passed, had wording almost identical to that of 26 U.S.C. 451(a) of the Revenue Act of 1954 presently in effect.

(c) The fact that all constructive receipt provisions were removed from the Act leaves no doubt that use of the doctrine for tax purposes is contrary to the wishes of the Congress and ". . . beyond the clear import of the language used . . ." in the statute, Gould v. Gould, 1917, 245 U.S. 140, 153.

(d) This observation withstands the comments which the House leaders made to "sell" the recision to the House, (Adams, Supra. p. 245). "The Congress could not add to or expand this statute by impliedly approving the regulation", C.I.R. v. Acker, 1959, 361 U.S. 87, 93.

(e) "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make laws but the power to adopt regulations to carry into effect the will of the Congress as expressed by the statute. . . . The regulation constitutes only a step in the administrative process. It does not, and could not, alter the Statute" Dixon v. U.S. 1965, 381 U.S. 68, 74.

(f) "The statute was evidently drawn with care. Its language is plain and unambiguous. What the government



asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertance , may be included within its scope. To supply omissions transcends the judicial function." Iselin v. U.S. 1926, 270 U.S. 245, 250-51.

2. "All" and "vested" are very comprehensive words. As used in Article I, Section 1, of the United States Constitution they leave no doubt that Congress has the sole authority to legislate; to the exclusion of the administrative departments, the Executive Department, and even the Courts. Slough v. C.I.R. 1945, 147 F.2d 836, 839.

3. The Tenth Amendment to the Constitution clearly restricts the powers of the Federal Government to those specifically delegated to it. Congress has not been authorized to delegate legislative power. The power of an administrative officer to make regulations ". . . is not the power to make laws - for no such power can be delegated by Congress-", Manhattan Gen. Equip. Co. v. C.I.R. 1936, 297 U.S. 133, 134.

4. Although this Court has determined that "constructive payment" is invalid, (sec.D, par.4, p.19, infra), the petitioner has not found a determination as to "constructive receipt". However, this Court has held that the attributes of constructive receipt, namely, regulations which extend or amend statutes or otherwise are contrary to the express wishes of the Congress, have no force of law, American Net and Twine Co. v. U.S. 1891, 141 U.S. 468, 474; Gould v. Gould, supra at 153; Lynch v. Tilden, 1924, 165 U.S. 315, 321; Iselin v. U.S. supra. at 251; Crooks v. Harrelson, 1930, 282 U.S. 55, 61; Manhattan G. E. Co. v. C.I.R. supra. at 134; Biddle v. C.I.R. 1938, 302 U.S. 573; Blatt v. C.I.R. 1938, 305 U.S. 267, 279; Busey v. Deshler Hotel Co. 1942, 130 F.2d 187, 191; Slough v. C.I.R. supra. at 839; Dixon v. U.S. supra. 74.

5. Particular attention should be given to the fact that this nullity of the constructive receipt doctrine is still in harmony with decisions of this Court in Corliss v. Bowers, 1930, 281 U.S. 376 and with Douglas v. Willcuts, 1935, 296 U.S. 1. Both of these cases involved cash transactions which would require



entries in the taxpayer's books in even the simplest of accounting systems. There was no need to resort to the artiface of constructive receipt. (See Reply Brief for appellant, p. 13-15).

6. It appears that 26 C.F.R. 1.451 and the constructive receipt doctrine is an unconstitutional usurpation of legislative power and null and void. Since the opinion of the Court below rests almost exclusively on this doctrine, it must follow that the decision and order is in error.

B. This case raises the constitutional question as to whether the respondent's method of assessing income taxes contravenes the Sixteenth Amendment.

1. This amendment delegates to the Federal Government the power to lay and collect taxes on income only. It does not authorize the assessment of income taxes on expenditures.

2. The Courts below, by their orders, have sanctioned the respondent's method which computes income taxes by assessing taxes on expenditures, namely, on taxes paid, (par. 5, p. 8, supra).

3. Since such power has not been delegated to the Federal Government, the method must be regarded as unconstitutional

C. Another constitutional question is whether the actions of the respondent and the orders of the Courts below violate the Due Process Clause of the Fifth Amendment.

1. When the respondent made the deficiency assessment he accused the petitioner of having unreported income in 1971 and of having violated the taxing statutes. (par. 5, p. 8, supra).

2. When such accusations are made, the petitioner has a fundamental right to be advised of either:

(a) From whom, how and when he received the alleged cash income, or

(b) As to the section of the taxing statutes which require him to report the non-cash item as income in 1971.

3. The I.R.S, knowingly and wantonly denied the petitioner this fundamental right when it refused to give this information because, "we do not operate that way."

4. The respondent thereby not only



denied the petitioner his right to adequately defend himself against these charges, but also confessed that the deficiency assessment was arbitrary and capricious.

5. The fact that petitioner keeps adequate records and that he signed his original 1971 return under penalties of perjury, "tend to suggest that taxpayer's returns are correct and may not arbitrarily be set at naught." Helvering v. Taylor, 1935, 293 U.S. 507, 513.

6. The respondent admits that state income taxes were handled in a manner which lies inside the plain intent of the Wisconsin Statutes, (par. 4, p.8, supra). Furthermore, he has never shown any reason to believe that petitioner's method does not comply with the intent of the federal taxing statutes.

7. The Federal Courts have consistently held that a taxpayer has the legal right to decrease his taxes, or avoid them altogether, by any means which the law permits, even though the results may be mischievous, absurd, produce a windfall, or be otherwise objectionable, so long as what was done, apart from the

tax motive, was the thing that the statute intended. U.S. v Isham, 1873, 17 Wall 496, 506; Bullen v. Wisconsin, 1916, 240 U.S. 625, 631; Gregory v. Helvering, 1935, 293 U.S. 465, 469; 123 East 54th Street v. U.S. 1945, 62 F.Supp. 488, 492; Fraser v. U.S. 1957, 156 F. Supp. 198, 200; Craven v. C.I.R. 1959, 272 F.2d 895,898; Pittsburgh Des Moines Steel Co. v. U.S. 1973, 360 F.2d 597, 599. "No one has to arrange his business affairs to satisfy the collector's appetite for revenues." Balthrope v. C.I.R. 1966, 356 F.2d 28, 34.

8. Although 26 U.S.C. 446(b) does permit the Commissioner to deviate from the taxpayer's regular method of accounting, this power is limited only to long-term liabilities, such as leases, payable over a period of years, Security Flour Mills Co, v. C.I.R. 1944, 321 U.S. 281, 285. In the case here at bar, the "Commissioner is required to compute taxable income under the method of accounting regularly used by the taxpayer," Cummings v. C.I.R. 1969, 410 F.2d 675, 679.

9. The taxing authority "may not arbitrarily impose its own preferred method



on the taxpayer, particularly when the taxpayer has consistently applied his method, without commissioner's challenge, for a reasonable period of time.[1/] Photo-Sonics, Inc. v. C.I.R. 1966, 357 F.2d 656; Adams, supra. p. 245.

10. The respondents method, even if it were free of error, which it is not, is at best an alternate method. It is therefor invalid to impose it on the petitioner who has adhered to his regular accounting method which is not in violation of the statutes.

11. It, therefor, appears to be a reasonable conclusion that the deficincy assessment and the orders of the Courts below are a deprivation of property without Due Process of Law.

D. The respondent's method contravenes the statutes and it own position and that of this Court in a prior case.

1. The statute, 26 U.S.C. 164, pro-

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1/ For 17 years petitioner has followed his method (par.2, p.7, supra). In correspondence about 1966, 1968 and 1969 returns I.R.S. was aware but did not challenge method (Stp. 28 & 29, Ex. C & D)

vides, for cash basis taxpayers, that state income taxes are deductible only in the year in which paid.

2. Pursuant to this statute, petitioner deducted from his 1970 tax return the state taxes paid through withholding in 1970, (par.3, p.7, supra).

3. Respondent, in his method, "allowed" the deduction of state taxes paid in 1970 not only from the 1970 return, but also from the 1971 return, the year in which no state income taxes were paid. (par. 6 & 7, p.8, supra),

4. This method can only be presumed to be "constructive payment" for which there is no support in the statutes, decisions of the courts, or even in regulations. In fact, the respondent, in Massachusettes Mutual Life Ins. Co. v. U.S. 1933, 288 U.S. 269, took the opposite stand, with which this Court concurred when it said, on pages 273-275, "It is settled beyond cavil that taxpayers other than insurance companies may not accrue receipts and treat expenditures on a cash basis, or vice versa. Nor may they accrue a portion of income and deal with the remainder on a cash



basis, nor take deductions partly on one and partly on the other basis. . . . The constructive payment theory is, we think, untenable."

E. The final question is whether the Order has any support in Statute Law, Administrative "Law", or in Case "law".

STATUTE LAW: --

1. The Court claims support under 26 U.S.C. 111, (App. 4), which is applicable only when the taxpayer has had a "recovery" of a prior tax deduction.

2. Since the cash basis petitioner has not had such a recovery in cash, (par.3, p.7, supra), it follows that the statute is no support, unless some other transaction occurred during the petitioner's 1971 tax year which the statutes define as such a "recovery".

3. Neither the respondent nor the Court has been able to produce such statutory support, nor has the petitioner been able to find any.

ADMINISTRATIVE "LAW": --

1. The Court postulates that in 1971 the petitioner "elected on his 1970 Wis-

consin state income tax return" (App. 1), at which time he "could have chosen to have the $2,577.29 refunded in cash", (app. 2), and therefor "constructively received the tax previously withheld", (App. 5), under the provisions of 26 C.F.R. 1.451, (App. 3).

2. This purported support for the Order is based on the hypostatization that the Administratuve "Law", 26 C.F.R. 1.451 has the force of law, which it does not, (Sec.A, par.6, p.13, supra).

3. Furthermore, the postulations of the Court below are contrary to the facts, namely:

(a) The petitioner did not make the election in 1971, as purported, but in 1970 when he instructed his employer to make the additional withholdings.

(b) It was prior to January 10, 1971, that petitioner "directed his employer not to withhold any monies for state income taxes" in 1971, (Stip. 12). Petitioner had a valid contract with his employer and with the state that his 1971 taxes were paid and that he would not claim a refund in 1971. He therefor had no right to a refund.



CASE "LAW": --

1. The Court below cites the following four cases as support for the Order:

(a) Union Trust v. Commissioner, (App. 4), and Universal v. Commissioner, (App. 5), both involve clear cash refund of prior tax deductions and are not germane to the case at bar.

(b) Security Flour Mills Co. v. C.I.R. 1944, 321 U.S. 281 is cited as support for the respondent's variance from the petitioner's regular accounting method, (App.3). For this case This Court carefully studied the history of the authority for a variance and said on pages 285-287 of the opinion:

> "From these reports it is clear that the purpose of inserting the qualifying clause was to take care of fixed liabilities payable in fixed installments over a series of years. . . . But we think it was not intended to upset the well understood and consistently applied doctrine that cash receipts or matured accounts due on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is neither a cash basis nor an accrual basis, because so to do would, in a given instance, work a supposedly more equitable result to the Government or to

> the taxpayer. . . . The uniform result has been denial both to Government and to taxpayer of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment."

Not only does this case fail to support the Order, it actually supports this petition for a writ, (Sec.C, par.8, p.16, supra).

(c) Helvering v. Taylor, 1935, 293 U.S. 507, is cited to put the burden on the taxpayer to "prove error in the I.R.S.'s determination" and to "prove his correct liability", (App. 3). This Court actually said that the taxpayer does not have to prove the correct amount of the tax and that he only need prove the I.R.S. determination to be "invalid", which is far different than "error", (See sec. D, par.10, p.17, supra). Furthermore, Helvering actually supports this petition for the writ, (Sec.C, par.5, p.15, supra).

2. Besides having no case support, the order of the Court below is out of harmony with opinions of this and other courts, to wit:

(a) The burden of proof is generally on the plaintiff, and on the taxpayer where the validity of a tax de-



duction is concerned. However, in a case such as this where the taxpayer has been denied a fundamental right and has signed the commissioner's amending return under duress, the burden of proof reverts back to the respondent, Rimanich v. U.S. 1966, 357 F.2d 537, 538; Davis v. Swenson, 1970, 308 F.Supp. 635, 640. Admittedly these are criminal cases, but the fundamental constitutional concepts still apply.

(b) The Court below asserts that taxation is based on what "could have" happened, (App. 2), in opposition to this and other courts which have held that "tax liability must be determined on the basis of what was done and not upon what might have been done", U.S. v. Phellis, 1921, 257 U.S. 156, 172; Founders Gen. Corp. v. Hoey, 1937, 300 U.S. 268, 275; Fraser v. U.S. 1957, 156 F. Supp. 198, 200.

(c) The petitioner's past practices and his actions in 1970 and early 1971 is compelling evidence that there was no likelihood of there ever being a recovery of the prepaid taxes. Other courts have held that, even for an accrual basis taxpayer, there can be no income unless

there is "likelihood that the income would be received within a reasonable time," Corn Exchange Bank v. U.S. 1930, 57 F.2d 34; Automobile Ins. Co. v. C.I.R. 1934, 72 F.2d 265, 267; H. Liebs and Co. v. C.I.R. 1937, 90 F.2d 932, 937, 938.

(d) Even though "there is an adjudication of an overpayment of taxes, and that a refund is in order, the refund is made when the money is paid. Refund means to pay back, return, restore, make restitution. That is the ordinary and popular concept of the word, and in the absence of a contrary indication, it must be presumed that the Congress used it in that generally accepted sense." Paulson, v. U.S. 1929, 78 F.2d 97,99.

3. In this case the respondent has made no attempt to address the basic issue of, "which statutes provide that the mere prepayment of taxes is a cash refund?" Instead he has cited a total of 38 cases to becloud the issue - successfully. The petitioner has examined 19 of these, including the four used by the Court to support its order and found that

4 support the petitioner's prepayment of state taxes,



3 are supporting this petition,
10 are not germane to this case,
1 could have been good support from the Tax Court if it had not reversed itself in a later case,
1 was an excellent case - in its time - under the constructive receipt provision of the Act of 1921, but that was expunged in the Act of 1924.

4. Since the Order of the Court below not only lacks any factual, statutory, regulatory, or case support but is also out of harmony with the opinions of this and other courts, it is deemed to be in error.

## CONCLUSION

Because these questions have been raised and ignored at all administrative and judicial levels through which this case has passed, and because of the compelling fundamental constitutional and statutory problems involved, it appears that it would be proper for this Court to grant a writ of certiorari to preserve the integrity of the Constitution,

the valid Acts of Congress, the courts below, and the very operation of our Government.

So prays the petitioner.

Respectfully submitted,

Ralph H. Schulz, Pro Se
9 High Point Circle No.
Naples, Fl. 33940
(813 - 261-6793

## APPENDIX

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

Ralph H. Schulz, Plaintiff
v. United States of America, Defendant

Civil Action No. 76-C-646
January 18, 1979

Before the court are cross motions for summary judgement in this action brought to recover taxes paid in an allegedly erromeous assessment of income taxes. The Government's motion for summary judgement is granted.

Plaintiff Ralph H. Schulz is a cash basis, calendar year taxpayer for both federal and state income tax purposes. for 1970 and 1971 he filed joint federal and state income tax returns with his wife and he paid the taxes. At his direction, his employer withheld $3,699.98 in Wisconsin state income taxes during the calendar year 1970. This amount was more than double the amount of their joint state tax liability for that year. Only $1,225.27 of that amount was applied toward payment of their 1970 tax liability. Mr. Schulz elected on his 1970 Wisconsin state income tax return to have the excess $2,577.29 retained by the State of Wisconsin to be held as a credit for future tax liabilities. Mr.

Schulz could have chosen to have the $2,577.29 refunded in cash.

On his federal income tax return for 1970, Mr. Schulz took an itemized deduction for the $3,699.98 in withheld state income taxes.

At Mr. Schulz's direction, his employer withheld no Wisconsin state income taxes during the year 1971. On his 1971 Wisconsin state income tax return, he applied the major portion of the $2,577.29 excess from the 1970 withholdings to his 1971 tax liability.

On his 1971 federal income tax return, Mr. Schulz took the standard deduction in arriving at his taxable income. He did not, however, include in his reported gross income for federal tax purposes the $2,577.29 state income tax overpayment credit.

Upon auditing the federal income tax return for 1971, the Internal Revenue Service ("I.R.S.") adjusted Mr. Schulz's gross income to include the $2,577.29 state income tax overpayment credit. An assessment of $517.76 was made against Mr. Schulz on February 11, 1974.

Mr. Schulz paid the assessment and filed an amended tax return, claiming a



refund on that amount. The claim was disallowed by the I.R.S. and this action filed.

Plaintiff's position is that the I.R.S. has acted capriciously in the assessment made in 1974 since no similar action was taken in 1968 or 1972, although he has previously used the same method of computing his taxable income. He also claims that the excess tax withheld in one year and used to pay taxes due in a second year cannot constitute a "refund" since the taxpayer never literally or physically receives the money. In that regard, 26 C.F.R. 1.451, which states that income "constructively received by the taxpayer" must be included in taxable income in the year received, is said to be an unconstitutional attempt by the Department of the Treasury to legislate.

The Government's position is that the burden of proof in a tax refund suit is on the taxpayer who must prove error in the I.R.S.'s determination and must prove his correct tax liability. Helvering v. Taylor, 293 U.S. 507 (1935). Thus, in this case, plaintiff would have to prove that he did not have construc-

tive receipt of 1970 state income tax overpayment.

The Government maintains that the taxpayer has constructive receipt of a state income tax refund when he elects not to receive it in cash but to apply it as a credit against future tax liability. Two doctrines are said to be the rationale for this principle: the annual accounting concept and the tax benefit rule. The annual accounting concept demands that each taxable year be treated as a separate unit. Security Mills Co. v. Commissioner, 321 U.S. 281 (1944). The tax benefit rule requires that if an amount deducted from gross income in one taxable year is recovered in a later year, that recovery is treated as income in the later year. See Union Trust Co. v. Commissioner, 111 F.2d 60 (7th Cir. 1940), cert. denied, 311 U.S. 658 (1940).

The two doctrines are codified in 26 U.S.C. 111. The statute, however, modifies the tax benefit rule so that to the extent the earlier deduction did not result in a tax benefit to the taxpayer, the recovery is not included in income.

On the basis of the facts of this case, Mr. Schulz did receive a tax ben-



efit from the earlier deduction. Furthermore, he constructively received the tax previously withheld in that he did not have taxes withheld from his earnings in 1971. The refund of taxes is includible in the taxpayer's income in the year of recovery where prior tax benefit has been found. Universal, Inc. v. Commissioner, 109 F.2d 616 (7th Cir. 1940).

IT IS THEREFORE ORDERED that plaintiff's motion for summary judgement is denied.

IT IS FURTHER ORDERED that defendant's motion for summary judgement is granted.

Dated at Milwaukee, Wisconsin, this 18 day of January, 1979.

(S) John W, Reynolds

John W. Reynolds, Chief Judge

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
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November 1, 1979

Before

Hon. WALTER J. CUMMINGS, Circuit Judge
Hon. PHILIP W. TONE, Circuit Judge
Hon. WILLIAM J. BAUER, Circuit Judge

RALPH H. SCHULZ,
Plaintiff-Appellant,

No. 79-1353 vs.

INTERNAL REVENUE SERVICE,
Defendant-Appellee.

Appeal from the
UNITED STATES DISTRICT COURT
for the
Eastern District of Wisconsin

No. 76-C-646
John W. Reynolds, Judge

Taxpayer appeals from entry of summary judgment in the district court on the government's cross-motion holding that taxpayer had constructively received an overpayment of state income taxes in 1971 and, thereby, denying him a refund on the assessment of $517.26 for that



on the assessment of $517.26 for that year.[1/] This court has jurisdiction under 28 U.S.C. 1291. Since the facts are stipulated and the law is plain, the attached judgment and opinion of the district court are adopted and affirmed.

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1/ After preliminary examination of the briefs, the court notified the parties that it had tentatively concluded that oral argument would not be helpful to the court in this case. The notice provided that any party might file a "Statement as to Need for Oral Argument." See Rule 34(a), Fed. R. App. P. (effective Aug. 1, 1979); Circuit Rule 14(f). No such statement having been filed, the appeal has been submitted on the briefs and record.